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Financial Markets

Irving Trust

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Economic Research &
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Just when you were getting tired of everyone harping about how badly M1 has performed relative to its target, another of the Fed's aggregates is threatening to become a problem: M3. Now don't jump to the conclusion that M1 is all right, it's not. But do realize that if the Fed were looking for excuses to tighten its credit policy, it would have two monetary aggregates that could support such a move. The current level for M1 is scary; it's about what it should be on Halloween (October). M3 is not so disoriented. Yet it is at the top of its target, and, given what M1 is doing, M3 at the top of its target is harder to ignore.

M3 is not a new ingredient in the recipe for good monetary policy, but it's one that has taken on a sharper taste. Through most of this year, the Fed has tried to convince the financial markets that the broader aggregates, M2 and M3, are going to be a better guide to policy. However, the M2 target is an odd construction, and M3 has hovered in the upper portion of its target range most of the year. These aggregates have not been strong counterpoints to the fast growing M1. Moreover, Fed officials have continued to refocus on M1 even after saying that it might be affected by some technical difficulties. With M1 way over the top of its target, M3's strong growth definitely has begun to close off some of the Fed's options. But what do we see for M3? Will it behave reasonably as the year unfolds?

No, I don't think that it will. Flow of funds data indicate that individuals have diverted massive amounts of funds from U.S. government Treasury and agency securities and open market paper. These funds, about $80 billion (SAAR) in the first quarter of 1983, have helped to balloon the deposits in bank MMDA accounts. Because MMDA accounts are included in M2 and M3, while the diverted funds are from sources outside M3, a continued rechanneling could result in continued excessive growth of M3 as the year progresses. Furthermore, because banks have replaced individuals (and then some) as purchasers of Treasury issues, the growth of M3 is reinforced. This is one aspect of reintermediation, the increased use of banks by the public. The funds in the banks are part of M3; conversely, when the public bought Treasury securities directly, these funds were not part of M3. Thus it appears that the change in bank regulations is leading banks to carry more assets than they otherwise might. M3 is bolstered as banks seek funding sources for these assets (or as assets are sought to cover funds the banks have acquired).

The bottom line for money is that M1 is a real problem, M2 is probably irrelevant, and M3 is a potential problem. On the other hand, the economy is looking sturdier by the day; housing starts, at an annual rate of 1.79 million units, are very strong. Although we have seen recent attempts by the markets to rally, it's unclear how rates can improve given the monetary problems and the state of the economy. In this regard, rumors of Mr. Volcker's imminent reappointment are interesting. Failure to reappoint Mr. Volcker will inject new uncertainties into the current situation. A Volcker reappointment, however, does not change the current economic picture. New Chairman or old Chairman, the outlook is for interest rates that are firm and firming.

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Market Yields

	6/17/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.88	8.75	14.13
Repurchase Agreements	8.88	8.63	13.00
U.S. Treasury Issues			
Bills			
3 months	8.95	9.04	13.08
6 months	9.28	9.36	14.17
1 year	9.50	9.59	14.40
Coupons			
2 years	10.08	10.10	14.80
4 years	10.37	10.45	14.80
7 years	10.62	10.80	14.65
10 years	10.67	10.83	14.35
Long Bond	10.75	10.92	14.08
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.00	9.00	14.60
3 months	9.10	9.25	15.00
6 months	9.45	9.50	15.25
1 year	9.75	9.95	15.25
Banker's Acceptances			
1 month	8.99	9.05	14.60
3 months	9.15	9.30	15.05
6 months	9.45	9.50	15.20
Eurodollar Deposits			
1 month	9.38	9.38	15.50
2 months	9.44	9.50	15.88
3 months	9.50	9.63	16.13
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.02	8.89	14.23
1 month	9.19	9.19	14.62
3 months	9.21	9.34	14.58
Bank Holding Companies			
1 month	8.68	9.07	14.36
Dealer Placed:			
3 months	9.24	9.39	14.71
New AA Corporate Utility Bond	11.80	11.80	16.80
Tax Exempt			
6 month Project Notes	4.90	4.95	8.00
1 year AAA Bond	5.50	5.55	8.00
5 year AAA Bond	6.75	7.00	9.75
20 year AAA Bond	8.70	9.50	11.90

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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